Robert W. Quinn, Jr.
Federal Government Affairs
Vice President

Suite 1000
1120 20th Street NW
Washington DC 20036
202 457 3851
FAX 202 457 2545

February 15, 2003

VIA ELECTRONIC FILING

Ms. Magalie Roman Salas
Secretary
Federal Communications Commission
445 12th Street, SW, Room TWB-204
Washington, DC 20554

Re: Notice of Ex Parte Presentation
In the Matter of Review of Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers and Implementation of the Local Competition Provisions in the Local Telecommunications Act of 1996, CC Docket Nos. 01-338; 96-98; 98-147

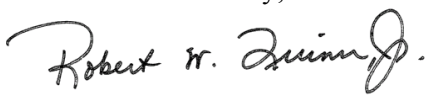
In the Matter of Appropriate Framework for Broadband Access to the Internet Over Wireline Facilities, CC Docket Nos. 02-33; 95-20; 98-10

Dear Ms. Salas,

On Thursday February 13, 2003, I had several discussions with Dan Gonzalez, Commissioner Martin's Senior Legal Adviser, to discuss issues raised in the aforementioned proceedings. I provided copies of the attached documents, which formed the basis of the discussion. In addition, we discussed AT&T's position on the impairment standard as summarized in the ex parte filing made by AT&T in a letter from Joan Marsh to the Commission on February 5, 2003. Finally, we also discussed the NARUC proposal filed before the Commission on February 6, 2003, the presumptions contained therein and the support filed by AT&T for that proposal yesterday.

The positions expressed in the discussions were consistent with those contained in the Comments, Reply Comments and ex parte filings previously made in the aforementioned dockets. One electronic copy of this Notice is being submitted for each of the referenced proceedings in accordance with the Commission's rules.

Sincerely,



cc: Dan Gonzalez

Joan Marsh
Director
Federal Government Affairs

Suite 1000
1120 20th Street NW
Washington DC 20036
202 457 3120
FAX 202 457 3110

February 13, 2003

Ms. Marlene Dortch
Secretary
Federal Communications Commission
445 12th Street, SW, Room TWB-204
Washington, DC 20554

Re: Notice of Written Ex Parte Communication, In the Matter of Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers, CC Docket Nos. 01-338, 96-98 and 98-147

Dear Ms. Dortch:

As AT&T and other carriers have demonstrated in this proceeding, there is substantial evidence that requesting carriers would be impaired in their ability to serve the mass market using voice-grade loops without access to unbundled switching. The availability of unbundled switching allows requesting carriers to combine the switching element with unbundled loops and transport to provide service through an arrangement known as the "UNE Platform." Using the UNE Platform, competitive carriers are, for the first time since the passage of the 1996 Act, able to compete against the incumbent LECs, serving over 10 million lines nationwide.

The incumbent LECs nonetheless continue, in the closing days of this proceeding, to urge the Commission to dramatically restrict the availability of UNE-P without regard to demonstrated impairment. They argue that the availability of UNE-P is inappropriate, asserting that it creates disincentives for both incumbent and competitive LECs to invest in new facilities, and they state that the Commission should promote facilities-based entry to the exclusion of other forms of entry such as UNE-P.

The Commission must look with suspicion on BOC claims that deregulatory relief will result in increased investment. In exchange for being allowed to merge, SBC and Verizon both promised to invest out-of-region to compete against other Bell companies. They did not. Network investment commitments were also made to State Commissions in Pennsylvania and Oklahoma in exchange for regulatory relief. These also remain unmet. And just last week, Verizon publicly admitted that a phaseout of UNE-P unbundling rules wouldn't result in an immediate increase in capital expenditures. Ivan

Seidenberg, chief executive officer of Verizon Communications, Inc., was quoted saying that, absent UNE-P obligations, Verizon would "start to develop the confidence to spend more," but that it would take 12-24 months for that confidence to "blossom."

Finally, as this proceeding draws to a close, a proceeding in which the Bells have championed the notion that intermodal competition will sufficiently police the marketplace and control monopolistic behavior in a deregulated wireline world, SBC has proven that it will invest whenever and where ever it believes investment is in its best corporate interest by announcing that it is willing to spend $10 billion to buy control of DirecTV – a major player in the satellite world that, in an intermodal world, is supposed to stand *against* SBC as a rival. SBC's announcement alone disproves the theory of intermodal competition.

The Commission should reject these ILEC arguments. As detailed in the attached paper, the record does not support the assertion that UNE-P creates inappropriate disincentives to invest in facilities. Indeed, if anything, the record shows that the availability of UNE-P will, in the long term, result in more investment in facilities, not less.

Consistent with Commission rules, I am filing one electronic copy of this notice and request that you place it in the record of the above-referenced proceedings.

Sincerely,

Joan Marsh

cc: Matt Brill
Jordan Goldstein
Dan Gonzalez
Chris Libertelli
Lisa Zaina
William Maher
Jeff Carlisle
Michelle Carey
Brent Olson
Rich Lerner
Scott Bergmann
Thomas Navin
Jeremy Miller

The Availability Of Unbundled Switching Promotes The Pro-Competitive Purposes of the Act And Investment In Local Network Facilities

As AT&T and other carriers have demonstrated in this proceeding, there is substantial evidence that requesting carriers would be impaired in their ability to serve customers using voice-grade loops without access to unbundled switching. The availability of unbundled switching would allow requesting carriers to combine the switching element with unbundled loops and transport to provide service through an arrangement known as the "UNE Platform" or UNE-P. Competitive carriers have recently made increasing use of UNE-P, and as a result, for the first time since the passage of the 1996 Act, competitive carriers are broadly offering local service to residential and small business customers in competition with the incumbent LECs. Indeed, competitive carriers using UNE-P have won over 10 million lines nationwide, most of them since the beginning of 2002.[1]

The incumbent LECs, however, urge the Commission to end the availability of UNE-P altogether and without regard to demonstrated impairment. They argue that the availability of UNE-P is inappropriate because it creates disincentives for both incumbent and competitive LECs to invest in new facilities, and that the Commission should, in effect, promote facilities-based entry to the exclusion of other forms of entry such as UNE-P.

The Commission should reject the incumbent LECs' arguments. Despite incumbent LEC claims, UNE-P does not create inappropriate disincentives to invest in facilities; to the contrary, the availability of UNE-P (in cases where there is demonstrated impairment) will, in the long term, result in more investment in facilities, not less. Thus, for the reasons explained below, the availability of UNE-P is affirmatively in the public interest, and non-UNE alternatives, such as the one proposed by SBC, are neither lawful nor appropriate.

Investment Incentives.

It cannot be over-emphasized that *USTA* required the Commission to review factors other than impairment in its unbundling analysis only when it seeks to mandate unbundling without a finding of impairment, which is not the case here.[2] In any event, the evidence of record refutes the claim that the availability of UNE-P saps carriers' investment incentives. In fact, the weight of the evidence demonstrates that, if anything, the availability of UNE-P increases the incentives of competitive and incumbent carriers alike to invest in local facilities.

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[1] *See, e.g.*, 1/16/03 PACE Ex Parte at 2; *see also* Louisiana at 2; New York at 3; California at iii, 5; Georgia at 4-5; Illinois at 2-3; Missouri at 7-8; Texas at 4.

[2] *USTA*, 290 F.3d at 425.

Before turning to the evidence, it is necessary to put these arguments into legal context. On the basis of nationally provided evidence, competitive LECs are generally impaired within the meaning of section 251(d)(2) without unbundled access to local switching in order to serve customers connected to voice grade loops. Thus, to the extent that the Commission does not make a national finding of impairment, it should, at a minimum, request the State commissions to review the local evidence to assure that such impairment exists at the local level as well. And to the extent that the Commission would be relying on section 251(d)(2)'s "at a minimum" to decline to order unbundling, where there is, as here, evidence of actual impairment, the Commission should not override the pro-competitive implications of such a determination unless there are strong reasons to believe that unbundling would, in fact, reduce investment incentives. There is no such evidence here. To the contrary, the weight of the evidence is that the broad availability of network elements promotes investment by competitive and incumbent carriers alike.

Impact of UNE-P On Incumbent LEC Investment Incentives. Although the D.C. Circuit specifically held in *USTA* that the Commission is not required to perform econometric studies to support findings on this issue,[3] the record provides the Commission with such data. That evidence establishes, if anything, that the availability of UNE-P increases incumbent LECs' incentives to invest in local networks.[4] In particular, AT&T has submitted studies that measure the cross-sectional variation in the terms and conditions upon which UNEs were available in the various states in order to test the linkage between the availability of UNEs, competitive LEC activity, and incumbent LEC activity. Employing standard econometric procedures, as well as several complementary techniques, these studies were able to measure directly how incumbent network investment was impacted by local competition, particularly local competition that resulted from UNE-P. Overall, this evidence shows a 1% reduction in UNE-P rates corresponds with approximately a 2.1% to 2.9% increase in incumbent LEC investment.

In response, the incumbent LECs complained that AT&T's regression studies were flawed. Principally, they claimed that AT&T had relied on UNE-P rates from June 2002 to explain competitive LEC activity and incumbent LEC investment from earlier periods.[5] However, AT&T provided amended studies that used UNE price data from a variety of sources complied from 1996 to 2002.[6] And regardless of the data used, the basic conclusion did not change: the econometric evidence showed, with statistical

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[3] *USTA*, 290 F.3d at 425.

[4] AT&T Reply, Willig Reply Dec., Technical App.; Willig, Lehr, Bigelow & Levinson, *Stimulating Investment and the Telecommunications Act of 1996* ("Willig *et al.* Econometrics White Paper") (attached to 10/11/02 AT&T Ex Parte).

[5] *See, e.g.*, Qwest Reply Comments, Harring-Rettle-Rohlfs-Shooshan Reply Dec.; SBC Reply, Kahn-Tardiff Reply Dec. App. 1.

[6] Willig *et al.* Econometrics White Paper at 32-35.

significance, that lower UNE-P rates lead to more network investment by the incumbent LECs.[7]

Ironically, the incumbent LECs' own testimony in this proceeding undercuts their position. In their "UNE-P and Investment" report, BellSouth, SBC and Verizon provide a competing econometric study on this issue.[8] That study, however, shows merely that incumbent LEC investment *neither increases nor decreases* as a result of increased availability of UNE-P. Given that competitive LECs may be significantly impaired without access to unbundled switching when they seek to serve customers connected to voice grade loops, the Commission should decline to mandate the unbundling of local switching in such cases unless there is compelling evidence that such unbundling is indeed likely to sap incumbent LECs' incentives to invest.[9] But the incumbent LECs' own evidence suggests that it has no impact on investment incentives, either positive or negative. Thus, even without according substantial weight to AT&T's econometric evidence, there is still no factual basis to adopt the incumbent LECs' position.

The incumbents' argument that UNE-P saps their investment incentives is also flawed from a theoretical perspective. There is no debate that UNE-P promotes competition that is likely to result in lower prices for telecommunications services. Such lower prices, in turn, can be expected to stimulate consumer demand. Some of the growing demand will be captured by the incumbent LEC and some of it will be captured

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[7] *Id.* The incumbent LECs also advanced a series of more technical claims. AT&T's subsequent filings responded to these criticisms by incorporating the changes advocated by the incumbents or by explaining why they were misplaced. *See id.* at 33-40.

[8] Qwest likewise filed testimony on this issue. *See* Qwest Reply Comments, Harring-Rettle-Rohlfs-Shooshan Reply Dec. Qwest's study is severely flawed and should be given no weight. Qwest's study attempts to explain the relationship between incumbent investment and UNE pricing by running a regression in which regional Bell operating company net plant in a state is a function of the number of RBOC loops, the number of unemployed persons in the state, real gross state product, and the product of the number of RBOC loops and the UNE loop price for zone 1. As Professor Willig explained, Qwest has "effectively performed the equivalent of a regression tautology." Willig *et al.* Econometrics White Paper at iv. Specifically, Qwest used RBOC net plant as the dependent variable, but then employed an equation in which that dependent variable is a function of loops. *Id.* at 41. It then examined whether total net plant is larger when the aggregate value of loops is larger (where loops are valued at the zone 1 UNE loop price). Not surprisingly, they find that this is the case. As AT&T has shown, this analysis is flawed because loops constitute a significant portion of net plant, so the result will likely be a positive relationship as a matter of arithmetic rather than as a policy-relevant causal relationship. Further, Qwest's use of net plant as the dependent variable is flawed because the relevant issue is how the availability of UNEs affects *investment*. *Id.* at 42. Investment is effectively indicated by *changes* in net plant, not the absolute level of net plant.

[9] *See* C. Michael Pfau, Correcting the RBOCs' Empirical Analysis of the Linkage Between UNE-P and Investment at 7 ("Pfau UNE-P Report Rebuttal") (attached to 10/22/02 AT&T Ex Parte).

by competitive LECs using UNE-P. In both cases, additional facilities investment will be required to service the demand.

Nor is price the only dimension along which increased competition will benefit consumers. As incumbent LECs face competition from competitive carriers, incumbents will have the incentive to use quality of service improvements and innovation as competitive tools to protect their own market share and to lure customers away from their rivals. Because most of these improvements must be embodied in network infrastructure, competition provides an added spur to increased investment.

To be sure, the rates that incumbent LECs charge for access to unbundled network elements can have an impact on their incentives to invest in expanding their networks. TELRIC-based rates for access to UNE-P do not materially impair these future investment decisions. Indeed, the incumbent LECs' own economists acknowledge that "in its reply brief to the Supreme Court, the FCC described how, in principle, TELRIC can be sufficiently flexible to accommodate investment risks in a way that is approximately correct economically."[10] And as the Supreme Court has now definitively held, the depreciation and cost of capital components of TELRIC allow the incumbent LEC to be compensated for all the risks that they assume in deploying facilities.[11] Further, because "TELRIC rates are calculated on the basis of individual elements," "TELRIC rates leave plenty of room for differences in the appropriate depreciation rates and risk-adjusted capital costs depending on the nature and technology of the specific elements to be prices."[12]

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[10] Verizon Reply, Kahn-Tardiff Reply Dec. n.52 (citing Reply Brief for Petitioner FCC in *Verizon Communications v. FCC*).

[11] *See Verizon*, 122 S. Ct. at 1677 ("TELRIC itself prescribes no fixed percentage rate as risk-adjusted capital costs and recognizes no particular useful life as a basis for calculating depreciation costs" and, therefore, may be "adjusted upward if the incumbents demonstrate the need").

[12] *Id.* at 1651. There is also no merit to the incumbent LECs' claim that it is "doubtful" that proper rates will "emerge from the regulatory process." Verizon, Kahn-Tardiff Reply Dec. ¶ 40. This is so, they say, because there have only been "slight differences between rates of return incorporated into TELRIC prices and those previously prescribed under rate-of-return regulations." *Id.* ¶ 40 n.52. The incumbent LECs offer no actual support for the empirical part of their assertion, and the Commission should reject the suggestion that, as a general matter, state commissions either willfully or inadvertently set rates with an inadequate return on capital. In any event, there are compelling reasons for believing, *a priori*, that the rates of return being set by state commissions for UNEs are appropriate. For example, interest rates have been extremely low for the past several years, which in turn lowers overall capital costs. Further, a carrier that provides "wholesale" access, even if forced to do so, can have lower risk than a carrier that does not, because the wholesale carrier can expect to benefit from having multiple parties offer retail services using its facilities and, therefore, is likely to have more traffic than if it is the only provider of service over such facilities. AT&T Reply, Willig Reply Dec. ¶ 88.

Competitive LEC Investment Incentives. Likewise, the evidence contradicts the claim that the availability of UNE-P impairs competitive LEC investment incentives. Again, AT&T has provided detailed econometric evidence that suggests strongly that the availability of UNEs enhances competitors' incentives to invest in local facilities.[13] AT&T collected state-by-state data on its use of facilities leased from the incumbent LECs for local network entry, as well as data representing its deployment of its own local facilities. Using a variety of established techniques, AT&T ran a regression to measure AT&T's own local facilities deployment in a state on AT&T's 2002 budgeted expenditures for leased local facilities in that state – controlling for the influence of leased facilities prices on these expenditures. In each case, the results show that the greater the use of leased facilities by AT&T, the greater the deployment of its owned facilities. Notably, no party challenged the accuracy of this study.

These results should hardly be surprising. The incumbent LECs' argument that the availability of UNE-P reduces competitive LECs' incentives to deploy switches to serve residential and small business customers necessarily assumes that such deployment is economically feasible. By definition, the availability of UNE-P cannot materially reduce the incentive to deploy an asset when, absent UNE-P, such assets would not be deployed to serve such customers. As explained above, the evidence establishes that, at least on a general basis, it is not economic for competitive LECs to deploy their own switches to serve the mass market. Further, as the record amply shows and all agree, one of the endemic problems that arose after the enactment of the 1996 Act was severe over-investment by competitive carriers.

Nevertheless, in their UNE-P and Investment Report, the incumbent LECs proffered a series of figures purporting to show a negative linkage between competitive carrier investment and UNE-P. The Commission should not accord this study any weight. The incumbent LECs rely on data that were specifically prepared for the report, are not attested to by knowledgeable affiants, and, most critically, are neither accurate nor consistent with verified data submitted directly to the Commission by the carriers themselves. Indeed, the record shows that simply substituting verified Commission data for the incumbent LECs' special purpose data renders invalid the results relied upon by the incumbent LECs.[14]

Further, the centerpiece of the UNE-P and Investment Report is a regression study that purports to compare competitive LEC facilities-based lines per 1,000 BOC access lines to competitive LEC UNE-P lines per 1,000 BOC access lines. That report concludes that there is less facilities-based competition in states where there is more use of UNE-P by competitive carriers, but that conclusion is not supported by the evidence, which, when taken in its totality actually contradicts the incumbent LECs' arguments. Specifically, the results provided by the Report use data from only a fraction of the states where data were available. The Report concedes, however, that "when all data points are included, the RBOC analysis shows *no statistically significant correlation* between UNE-P and

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[13] *See generally* AT&T Reply, Clarke Reply Dec.

[14] *See generally* Pfau UNE-P Report Rebuttal.

facilities-based lines."[15] "Results" that occur only when a data set is censored to remove inconvenient observations are simply not methodologically sound results.

In short, although the *USTA* court did not require "multiple regression analyses"[16] on the issue of the link between unbundling and investment incentives, the record here provides such analyses. And the most rigorous of these studies conclude that the availability of UNEs enhances the incentives of both competitive and incumbent carriers to invest in local facilities. But even if the Commission had reasons to question the quality of these studies – and they were not effectively rebutted by any of the commenters – the incumbent LECs' own evidence undermines their position. That evidence shows that there is no statistically significant correlation between UNE-P and investment by either competitive or incumbent carriers. Accordingly, given that competitors will only have access to unbundled local switching if they are materially impaired without such access, the record evidence on investment incentives provides no basis to refuse to require such unbundling.

UNE-P And Section 271.

On the other hand, there are strong policy reasons for retaining competitive access to UNE-P. Elimination of UNE-P would be antithetical to section 271 of the Communications Act and the decisions that the Commission and State commissions have made pursuant to that section. It is well known that so long as the BOCs "enjoy a monopoly on local calls" they will "ineluctably leverage that bottleneck control in the interexchange (long distance) market" if they are free to offer long distance services.[17] In the 1996 Act "Congress chose to maintain . . . the MFJ's [long distance] restrictions . . . until the BOCs open their local markets to competition."[18] Congress understood that allowing Bells to provide long distance services would severely impair competition in that market unless there were mechanisms that would make it as easy and as economic for IXCs ubiquitously to provide local services as it was for the Bells to provide long distance.[19] Accordingly, the Commission orders granting the Bells entry into the long

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[15] UNE-P and Investment Report at n.5 (emphasis added).

[16] *USTA,* 290 F.3d at 425.

[17] *United States v. Western Elec. Co.*, 969 F.2d 1231, 1238 (D.C. Cir. 1992).

[18] *Qwest Teaming Order* ¶ 5.

[19] This can be seen clearly in the legislative history of the 1996 Act. *See, e.g.*, 141 Cong. Rec. S8057 (1995) (statement of Sen. Dorgan) ("The Bell operating companies are not now free to go out and compete with the long distance companies because they have a monopoly in most places in local service. It is not fair for the Bell operating companies to have a monopoly in local service, retain that monopoly and get involved in competitive circumstances in long distance service."); S. 652, 104th Cong., § 5(3) (1995) ("[b]ecause of their monopoly status, local telephone companies and the [BOCs] have been prevented from competing in certain markets") (emphasis added); 141 Cong. Rec. S8138 (1995) (statement of Sen. Kerrey) ("[t]he question is whether or not to grant long-distance competitive opportunity, and that question is answered by determining whether or not there is competition at the local level"); 141 Cong. Rec. H8281 (1995) (statement of Rep.

distance market pursuant to that statute, and the State commission recommendations on which the Commission relied in making those decisions, have been predicated on the fact that UNE-P is available to competitive carriers because, absent this entry vehicle, the Bells would be able to remonopolize long distance services provided to residential and small business customers. Having granted the Bells entry into the long distance market on the basis of the broad availability of UNE-P, it would plainly be improper to eliminate it here except on a definitive showing that competitive carriers are not impaired without it.

Specifically, the Commission's section 271 orders rely on UNE-P to satisfy the basic statutory preconditions to a grant of long distance authority in three distinct ways. First, the Commission has determined that the existence of UNE-P competition is highly important for determining whether a BOC satisfies the requirements of "Track A" of Section 271,[20] which requires the BOC to show the existence of "interconnection agreements with one or more competing providers of 'telephone exchange service . . . to residential and business subscribers'" who are "predominantly" providing these services over their own facilities.[21]

Second, the Commission has refused to find that a BOC's OSS satisfies the competitive checklist unless it demonstrates the existence of an adequate interface for the ordering and provisioning of UNE-P to the mass market at all commercially obtainable volumes of orders.[22] Absent OSS capable of supporting UNE-P to the mass market, the Commission has found that a competing carrier "will be severely disadvantaged, if not precluded altogether, from fairly competing in the local exchange market," because IXCs and other competitive carriers will be incapable of offering local service to residential and small business customers throughout the state.[23]

Finally, and most importantly in this context, the Commission has relied upon the existence of UNE-P competition in assessing whether a section 271 application is in the "public interest." As the Commission has held, "[i]n making [a] public interest assessment, [the Commission] cannot conclude that compliance with the checklist alone is sufficient to open a BOC's local telecommunications markets to competition."[24] Rather, the "public interest" requirement of section 271 imposes the additional condition

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Bliley) ("[o]nce the [BOCs] open the local exchange networks to competition, the Bell companies are free to compete in the long distance and manufacturing markets").

[20] *See, e.g., id.*; *Georgia-Louisiana 271 Order* ¶¶ 13, 15; *New Jersey 271 Order* ¶ 11.

[21] *Kansas-Oklahoma 271 Order* ¶ 40 (quoting 47 U.S.C. § 271(d)(3)(A)).

[22] *See, e.g., Georgia-Louisiana 271 Order* ¶¶ 103, 122-26, 136, 151, 155; *Kansas-Oklahoma 271 Order* ¶ 158; *Massachusetts 271 Order* ¶¶ 78-80; *Michigan 271 Order* ¶ 128.

[23] *Kansas-Oklahoma 271 Order* ¶ 105 (quoting *New York 271 Order* ¶ 83). It should also be noted that OSS interfaces for UNE-L offerings are far more complex than those for UNE-P.

[24] *Michigan 271 Order* ¶ 389.

that the BOC must show that local markets are, in fact, irreversibly open to competition.[25] "The most probative evidence" on this point is hard "data" showing that there is sufficient usage of UNE-P that enables us to find with confidence that competitive LECs are, in fact, able to serve residential and small business customers.[26]

In its recent decision in *Sprint Communications L.P.* v. *FCC*,[27] the D.C. Circuit confirmed that section 271's public interest requirement imposes a greater limitation than the competitive checklist, and that the Commission must ensure that the applicant will not be able to leverage its local market power anticompetitively into adjacent long distance markets. Specifically, in the Kansas-Oklahoma section 271 proceedings, AT&T contended that even if SBC's prices for UNE-P fell within the range allowed by TELRIC, they had been set at a point in the range that was too high to allow local competition for "low volume" consumers and, therefore, that long distance carriers would not be able to offer the same bundle of local and long distance services as SBC in Kansas and Oklahoma. On appeal, the court rejected the Commission's argument that it did not need to assess this evidence because it had already determined that SBC's rates were within the "zone of reasonableness" of TELRIC.[28] The *Sprint* court held that, even if UNE-P rates satisfied the checklist, that fact by itself is not sufficient to show that the BOC has met the independent "public interest" requirement of section 271(d)(3)(C).[29] The court concluded that UNE-P rates might be in the zone of reasonableness but at the same time too high to prevent effective competition for consumers.[30] The court therefore held that where UNE-P rates were too high to permit meaningful competition, the "public interest" demanded that the Commission order the BOC to lower its rates to the lower bounds of the permissible zone in order to "stimulate competition."[31] Since the *Sprint* decision, the Commission has consistently evaluated section 271 applications with those concerns in mind, and the Commission not only has found that the checklist has been met, but it has also determined that there is no "price squeeze," so that UNE-P is available at rates that

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[25] *See, e.g., Kansas-Oklahoma* ¶ 267; *New York 271 Order* ¶ 423.

[26] *Michigan 271 Order* ¶ 39. *See also New York 271 Order* ¶ 230 ("Because the use of combinations of unbundled network elements is an important strategy for entry into the local telecommunications market, as well as an obligation under the requirement of section 271, we examine section 271 applications to determine whether competitive carriers are able to combine network elements as required by the Act and the Commission's regulations."); *see also id.* ¶ 233; *Texas 271 Order* ¶ 5; *Massachusetts 271 Order* ¶ 3; *New Jersey 271 Order* ¶ 3; *Georgia-Louisiana 271 Order* ¶ 3.

[27] 274 F.3d 549 (D.C. Cir. 2001).

[28] *Id.* at 555.

[29] *Id*.

[30] *Id.*

[31] *Id.*

will allow broad-based local service to residential and small business customers in competition with the BOCs.[32]

In short, the Commission's prior section 271 orders, and the court of appeals review of those orders, assumed that UNE-P would available at rates that were sufficient to allow competitors to serve residential and small business customers. The Commission made these determinations in order to ensure a level playing field for residential and small business customers. Eliminating UNE-P now would call into question this essential predicate of the Commission's prior orders. Moreover, the BOCs accepted these requirements as the predicate for their entry into the long distance market. It would clearly be inappropriate to allow them to renege on their commitments, or to jeopardize the competitiveness of that market, by allowing them to avoid the duty to make UNE-P – the principal vehicle that supports mass-market competition – available at cost-based rates.

Incumbent LEC Proposals To Provide "UNE-P- Like" Services.

Finally, the Commission should reject SBC's alternative proposal that would permit incumbent LECs to offer, as a substitute for UNE-P, a "UNE-P like service" at rates that are substantially above TELRIC levels.[33] The incumbents argue that these offers would provide sufficient "margins" for competitive LECs to compete for customers and provide them with a transition mechanism to deploying their own switches in order to provide residential and small business services on a UNE-L basis. Such offers are an insufficient basis to deny competitive carriers with access to unbundled switching and, by extension, UNE-P.

First, the Commission has already rejected such incumbent LECs claims, and the courts have upheld that determination. The Commission rejected this argument in the *Local Competition Order* (¶ 287), and then again in the *UNE Remand Order* (¶ 354). As the Commission explained, allowing incumbent LECs to substitute above-cost tariffed special access services for UNEs would undermine the market-opening obligations of the Act:

> If we were to adopt the incumbents' approach, the incumbents could effectively avoid all of the 1996 Act's unbundling and pricing

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[32] *See, e.g.*, *Georgia-Louisiana 271 Order* ¶¶ 283-290; *New Hampshire-Delaware 271 Order* ¶¶ 142-52; *Alabama-Kentucky-Mississippi-North Carolina-South Carolina 271 Order* ¶¶ 279-92.

[33] 1/14/03 SBC Ex Parte. Verizon and Qwest advance similar proposals under which they would offer a "UNE-P like service" at rates that would increase in steps from current levels to a level that reflects existing discounts for resold services. *See* 1/10/03 Verizon Ex Parte; 1/30/03 Qwest Ex Parte. The Commission should reject these proposals for the same reasons it should reject SBC's. *See also* AT&T's 1/23/03 Ex Parte (which demonstrates that the resale discounts available under the Act are not market based and are very dissimilar to the kind of resale opportunities that were (and are) available for long distance services and which the Bells rely upon in providing their long distance services).

> requirements by offering tariffed services that, according to the incumbents, would qualify as alternatives to unbundled network elements. This would effectively eliminate the unbundled network element option for requesting carriers, which would be inconsistent with Congress' intent to make available to requesting carriers three different competitive strategies, including access to unbundled network elements.[34]

Notably, in its review of the *Local Competition Order*, the Eighth Circuit "agree[d]" with the Commission that relieving incumbent LECs of unbundling requirements on the ground that a UNE's functionality could also be provided in the form of a wholesale service improperly "would allow the incumbent LECs to evade a substantial portion of their unbundling obligation under subsection 251(c)(3)."[35] And in upholding this aspect of the Eight Circuit's decision, the Supreme Court held that the "impairment" inquiry must focus on whether a requesting carrier can offer service through "self-provision, or with purchase from *another carrier*" – *not* through services purchased from the incumbent.[36]

Thus is it settled that incumbents may not effectively avoid all of the 1996 Act's unbundling and pricing requirements by offering tariffed services that, according to the incumbents, would qualify as alternatives to unbundled network elements. This would effectively eliminate the unbundled network element option for requesting carriers, which would be inconsistent with Congress' intent to make available to requesting carriers three different competitive strategies, including access to unbundled network elements."[37]

Further, the Commission should reject the incumbent LECs' claim that it should decline to order cost-based access to UNE-P based on the assertion that UNE-P like service offers permit competitive LECs to earn positive "margins" for some customers. Regardless of current margins, entry is unlikely where the incumbent LEC has an "absolute cost advantage" relative to the entrant.[38] This is basic economics. Where a competitive LEC must incur significantly higher costs to provide local services, an incumbent LEC can respond to entry by dropping prices below the competitive carrier's

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[34] *UNE Remand Order* ¶ 354.

[35] *See Iowa Utilities Board v. FCC*, 120 F.3d 753, 809 (8th Cir. 1997), *aff'd in part and rev'd and remanded in part on other grounds*, *AT&T Corp. v. Iowa Utilities Board*, 525 U.S. 366 (1999)

[36] *Iowa Utils. Bd.*, 525 U.S. at 389-90 (affirming the Eighth Circuit) (emphasis added).

[37] *UNE Remand Order* ¶ 354.

[38] Jean Tirole, THE THEORY OF INDUSTRIAL ORGANIZATION 306 (1988). This would clearly be the case here. The evidence is that SBC's proposed $26 per month charge is well in excess of the TELRIC-based rates that the state commissions have set for UNE-P in the SBC states. *See* 9/25/02 AT&T Ex Parte (state commissions in SBC states have, on average, priced residential UNE-P at $16.07 per month).

costs.[39] Such a pricing strategy will still allow the lower-cost incumbent to remain profitable; but by setting prices below the competitive LEC's costs, the incumbent LEC would make it impossible for the competitive LEC to remain economically viable.[40] Entry under these conditions would be at the sufferance of the incumbent LEC and could be stamped out at any time.[41]

Entry that is sufficient only to prevent incumbent LECs from increasing charges that, in many circumstances, are already above cost does not fulfill the pro-competitive goals of the Act. The Act requires network elements to be priced at levels that reflect the incumbent's economic cost of providing those elements in order drive retail prices to levels that would exist in competitive markets.[42] Indeed, the Supreme Court has found that the purpose of the Act is affirmatively to *change* the competitive landscape by "giv[ing] aspiring competitors every possible incentive to enter local retail markets, short of confiscating the incumbents' property."[43]

Finally, even to the extent that margins were relevant, SBC's offer is clearly inadequate.[44] SBC acknowledges that, given existing retail rates, its offer would not permit competition for all customers. Indeed, it would at best permit competition for only a fraction of mass-market customers. Specifically, SBC claims that, after accounting for all of the costs of entry, its proposal would permit competitive LECs to profitably serve customers that generate $48 to $68 per month in combined local and long distance revenues. However, the available data show that less than 19 percent of all residence lines generate combined local and long distance revenues of $48 or greater, and less than 7 percent generate combined revenues of $68 or greater.[45] Congress intended to open local markets for "All Americans," not just the small fraction of customers that are the most intensive users of telecommunications services.[46]

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[39] *See generally See* Robert D. Willig, "Determining 'Impairment' Using the *Horizontal Merger Guidelines* Entry Analysis" at 7 (attached to 11/14/02 AT&T Ex Parte); 1/10/02 Ex Parte Letter from Judge Robert Bork to Chairman Michael Powell at 2-3.

[40] *See* Richard Gilbert, *Mobility Barriers and the Value of Incumbency*, in I HANDBOOK OF INDUSTRIAL ORGANIZATION 493 (Richard Schmalensee and Robert Willig, eds. 1989) ("If a potential entrant has a cost disadvantage with respect to an established firm, this is a factor that can allow the established firm to maintain a price above cost.").

[41] *See generally* 1/31/03 AT&T Ex Parte.

[42] *See Local Competition Order* 679; *UNE Remand Order* ¶ 55.

[43] *Verizon Communications Inc. v. FCC*, 122 S. Ct. 1646, 1661 (2002).

[44] *See generally* 2/03/03 AT&T Ex Parte.

[45] 1/15/03 AT&T Ex Parte at 3-4.

[46] Conference Report, 104th Cong. 2d Session, Report 104-458.